



Investment Challenge Program Annual Report 2002

Message from the Program Manager...

Hello, Investors!

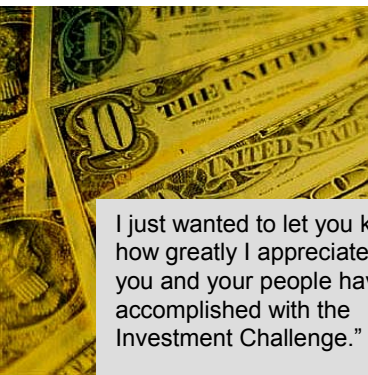
It seems the Investment Challenge Program has been quite a success! Since the program moved from a concept to a reality back in 1998, the ICP has been able to outperform the S&P 500 four out of the five award periods, which is quite exceptional. Our most exciting developments this year came as a result of this success. Last fall, TVA decided to allow six new schools to participate in the program: Belmont University, Lipscomb University, Trevecca Nazarene University, and Vanderbilt University, all in Nashville, Union University in Jackson, TN, and Christian Brothers University in Memphis. The Nuclear Decommissioning Trust Board also decided to increase the Investment Challenge Program's funding to \$10 million.

As you know, 2002 was an unusual year for the equity markets, taking us from one extreme to another. Very early in the year, outlook against the War on Terrorism was positive and everyone seemed to think 2002 would bring economic expansion. At least this was true for the first quarter of the year. During this time, the U.S. economy grew at a rate unmatched since the 4th quarter of 1999, 5.8% annually. Everything changed, however, as the year went along. Worries surfaced that the U.S. could possibly enter a double dip recession. This, combined with a few high profile bankruptcies and scandals, started the economy into a downward trend. By the fourth quarter of 2002, the markets were overshadowed with the possibility of an impending war with Iraq. Risk aversion seemed to be in vogue as gold funds gained more than 62% during 2002. I am proud to announce, however, that the Investment Challenge Program was able to excel in such a market and outperform the S&P 500 during 2002 by 170 basis points. During 2002, the Investment Challenge Program returned a negative 20.4%, while the S&P 500 returned a negative 22.1%, the BARRA Growth Index returned a negative 23.6%, and the BARRA Value Index returned a negative 20.9%.

For the three-year period, the Investment Challenge Portfolio underperformed the S&P 500 by 110 basis points. During this time period, the Investment Challenge Program returned a negative 15.7% while the S&P 500 returned a negative 14.6%, annualized. This underperformance is largely due to the drop-off of our stellar year during 1999 in the rolling three-year performance calculation.


Looking to the future, I feel very confident that the Investment Challenge Program will continue to outperform the benchmarks.

I thank you for your hard work and wish you good luck in 2003!



I just wanted to let you know how greatly I appreciate what you and your people have accomplished with the Investment Challenge."

*Lewis E. Wallace,
Chairman
TVA Retirement Services
Board of Directors*



The Investment Challenge Program course differs from all other courses on campus. Students get the opportunity to put their learning from traditional courses to work. In their exit interviews before graduation, the students consistently name this course as the best course at the university.

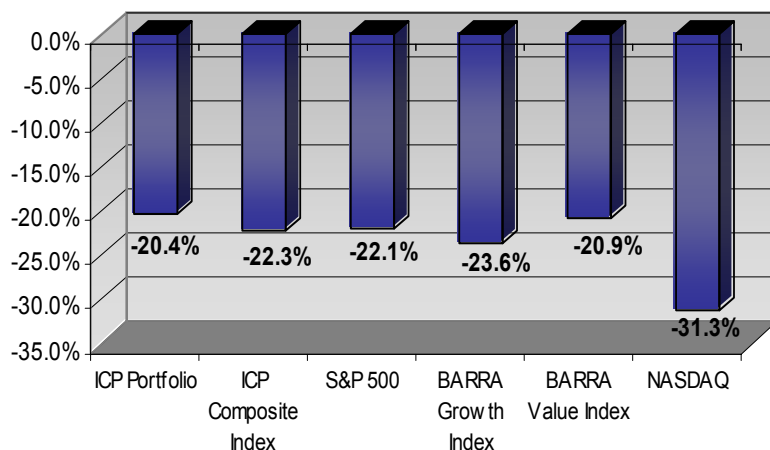
*Dr. Bob Wood
Associate Professor of Finance
Tennessee Technological University*



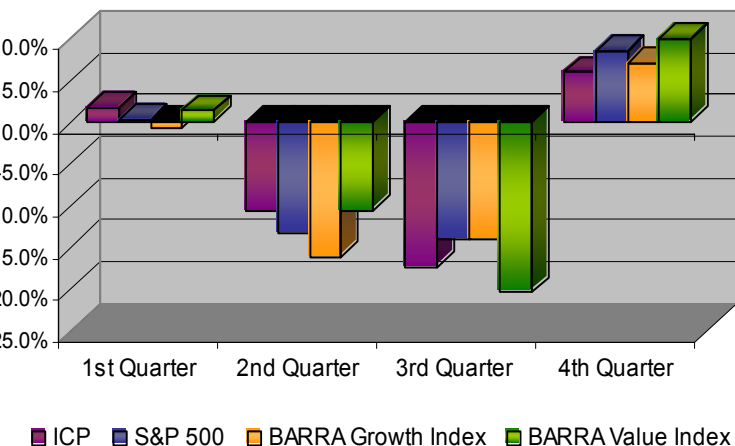
Our Performance in 2002...

2002 was a very volatile year for the equity markets. It almost seemed there was no rhyme or reason to the market's volatility. Even though the value approach outperformed the growth approach overall, there were certain opportunities during 2002 where growth investors had the upper hand. In spite of this rivalry, the Investment Challenge Program portfolio was able to outperform both the BARRA Growth and the BARRA Value benchmarks. For the year, the ICP returned a negative 20.4 %, followed by the BARRA Value, which returned a negative 20.9%. The S&P 500 returned a negative 22.1% and the BARRA Growth returned a negative 23.6%. The NASDAQ returned a negative 31.3%.

Index Comparison for 2002



Quarterly Comparison for 2002



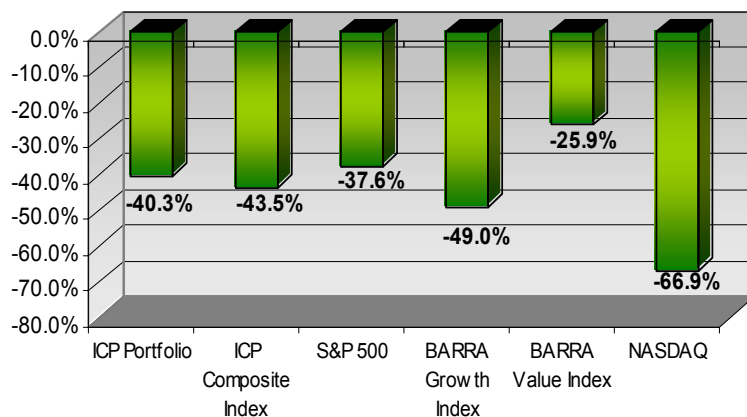
Quarterly Performance for 2002

The Investment Challenge Program was able to outperform the S&P 500 during the first two quarters of the year by 1.4% and 2.8%, respectively. During these two quarters, the ICP portfolio was also able to outperform or at least match the performance of both the BARRA Growth and BARRA Value indices. During the 3rd and 4th quarters of the year, the ICP portfolio underperformed the S&P 500 by 3.2% and 2.4%, respectively. This underperformance is largely due to two factors. First, the ICP portfolio has a Value bias to it and during the third quarter of 2003, the BARRA Value Index returned a -20.4%, as compared with the S&P 500's return of -14.1%. Second, the ICP portfolio's performance tends to lag behind a market with positive returns.

Three Year Performance...

The Investment Challenge Program returned a negative 40.3% for the three-year period ended December 31, 2002, while the S&P 500 returned a negative 37.6% over the same period. The ICP portfolio was able to outperform the S&P 500 on a three year-to-date basis through October 2002. However, due to the rolling time period calculation, we lost two exceptional months, November and December of 1999, when we added November and December of 2002, which were not quite as exceptional. In addition, 2000 was an extremely difficult year for the Investment Challenge Program because of an overweighting in the Information Technology sector. 2001 and 2002 turned out to be better years for the portfolio, outperforming the S&P 500 by 4.4% and 1.7%, respectively.

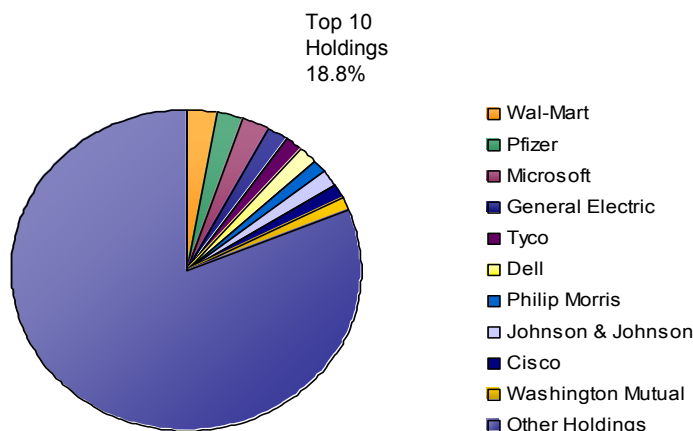
3 Year Performance Comparison (2000-2002)



Top 10 Holdings....

		Market Value	Percent of Portfolio
1	Wal-Mart	\$45,307	2.82
2	Pfizer	39,435	2.45
3	Microsoft	39,292	2.44
4	General Electric	31,655	1.97
5	Tyco	27,328	1.70
6	Dell	26,259	1.63
7	Philip Morris	24,683	1.54
8	Johnson & Johnson	24,170	1.50
9	Cisco	23,292	1.45
10	Washington Mutual	21,236	1.32

ICP Holdings Allocation

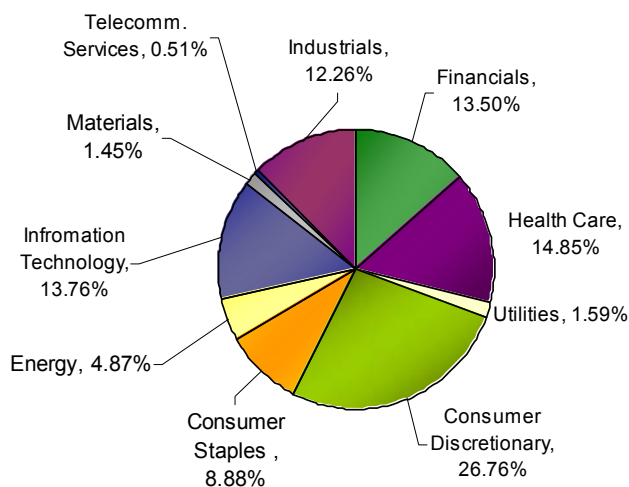


The top ten holdings of the Investment Challenge portfolio account for almost 19% of the total portfolio. The average market capitalization for the top ten holdings is \$131.8 billion, with Microsoft being the largest at \$253.5 billion, and the smallest, Tyco, at \$30.5 billion. As of December 31, 2002, the Investment Challenge portfolio owned 270 different companies.

Sector Allocation

As of December 31, 2002, the ICP portfolio held its greatest concentration in the Consumer Discretionary sector, with 26.8% of total equity holdings. The Health Care and Information Technology sectors accounted for 14.9% and 13.8%, respectively. The smallest concentration was in the Telecommunication Services sector, which held less than 1% of total equity holdings. The S&P 500 Index, comparatively, held its greatest concentration in the Financials sector (20.5%), followed by Health Care (15.1%), and Information Technology, (14.5%).

ICP Sector Allocations



ICP vs. S&P 500: Sector Allocations

Sectors	Percent ICP	Percent S&P 500
Consumer Discretionary	26.8%	13.5%
Health Care	14.9%	15.1%
Information Technology	13.8%	14.5%
Financials	13.5%	20.5%
Industrials	12.3%	11.2%
Consumer Staples	8.9%	9.6%
Energy	4.9%	5.6%
Utilities	1.6%	2.9%
Materials	1.5%	2.9%
Telecommunication Services	0.5%	4.3%

The portfolio was overweighted in the Consumer Discretionary and Industrials sectors by 13.3% and 1.1%, respectively.

Summary of the ICP....

The Program

The Investment Challenge Program is a unique partnership between TVA and participating universities. The partnership helps students to obtain real-world investment knowledge and experience while providing TVA with a valuable recruiting and marketing tool. The students also know they play an important role in helping TVA to achieve investment returns which will go toward the decommissioning of its nuclear plants.

Conferences

Each year, TVA hosts two conferences, one featuring an Awards Ceremony and one featuring a Job Fair. At the Spring conference in April 2002, we recognized the outstanding achievement of our top three performing universities for 2001. The winners were: University of Tennessee, Knoxville, with a positive 24.2% return, Murray State University, with a positive 0.8% return, and Austin Peay University, with a negative 1.3% return for the year. The S&P 500 Index returned a negative 11.9% over the same period.

The Fall conference in October boasted a successful Job Fair, with a total of forty-three companies in attendance. A small sample of those recruiting at the conference were Pricewaterhouse Coopers, Wilshire Associates, United Parcel Service, Eli Lilly and Company, as well as many other regional and national firms of distinction.

Investment Challenge Program Success Story

Because of the Investment Challenge Program's outstanding performance over the past four years, TVA's Board of Directors decided to allocate additional money to the program, to bring the total under management by the universities to \$10 million. Along with the additional money, TVA also invited six private universities to join the program, for a new total of 25 universities participating in the Investment Challenge Program.

The Universities of the Investment Challenge Program...

Location of Investment
Challenge Universities

